This record is a partial extract of the original cable. The full text of the original cable is not available.

141055Z Feb 06

UNCLAS SECTION 01 OF 02 PARIS 000929

SIPDIS

PASS FEDERAL RESERVE
PASS CEA
STATE FOR EB and EUR/WE
TREASURY FOR DO/IM
TREASURY ALSO FOR DO/IMB AND DO/E WDINKELACKER
USDOC FOR 4212/MAC/EUR/OEURA

E.O. 12958: N/A
TAGS: EFIN ECON PGOV FR
SUBJECT: FRENCH ECONOMIC GROWTH SLOWS IN Q4 2005

Ref: 05 PARIS 7771

¶1. SUMMARY. France's Q-4 GDP growth of 0.8% (annualized) means that GDP only increased 1.4% in 2005, down from 2.1% in 2004. Foreign trade contributed negatively to GDP growth, posting a record deficit. The Government reiterated it still would meet its objective to reduce the budget deficit to below 3% of GDP in 2005. END SUMMARY.

GDP Growth Slows in Q-4

¶2. Based on the National Statistical Agency (INSEE) flash estimate, GDP (seasonally and workday adjusted) increased 0.8% (annualized) in Q-4 compared with 2.8% in Q-3. For the year, GDP therefore only increased 1.4%, compared with 2.1% in 2004, below the government's 1.5-2.0% target range. While the flash estimate did not include a breakdown, GDP growth is likely to have been driven by sluggish household consumption, which had driven GDP growth in previous quarters. Falling industrial production, notably in the automobile sector, November's civil unrest (reftel) and the foreign trade deficit had a negative impact on economic growth in Q-4. Finance Minister Thierry Breton blamed technical stoppages in the automobiles sector (ten days in several Renault's and PSA Peugeot Citroen's concerns). Industrial production decreased 0.3% in December compared with November. According to head of macro-economic forecasts Michel Devilliers, the agriculture sector also contributed to the poor Q-4 performance.

GOF Maintains Optimism

¶3. Breton stressed that GDP estimates could be revised upward as "the Q-4 GDP growth figure is not totally in line with what can be observed in facts", saying he was sticking to the government 2.0-2.5% GDP forecast for 2006. He added he is still "very confident" about cutting the budget deficit to below 3% of GDP in 2005 since "the tax receipts, whether in corporate tax and VAT, were good, better than we expected."

¶4. Devilliers indicated that 2% GDP growth in 2006, the low of the government GDP growth forecast, was still achievable. He admitted that Q-4 GDP growth was lower than INSEE's forecast of 2.0% (annualized), but said that GDP growth was running in early 2006 on a 2.0% (annualized) pace.

Foreign Trade Deficit hit a Record 26.4 billion euros

¶5. The foreign trade deficit (FOB/FOB) including military equipment more than tripled to 26.4 billion euros in 2005 compared with 2004. Imports increased 9.2% to 382 billion euros. The increase in imports was mainly due to the cost of imported energy, which resulted in an increase in the energy deficit to 37 billion euros. Purchases of imported consumer goods from China increased to 21 billion euros in 2005 from 17 billion euros in 2004. Exports increased 4.1% to 355 billion euros, helped by strong growth in exports to India (42%), China (15%), and the U.S. (9%). Nonetheless, France's export performance was not as good as the 7.5% increase that Germany's exports enjoyed in 2005 (totaling 786.1 billion euros).

¶6. Some private-sector economists explained the deterioration in French foreign trade was due to a lack of competitiveness of exports due to high labor costs. Some economists disagreed that labor costs fully explained export performance, especially when comparing performance with Germany since labor costs in Germany were also high. In their view, the export mix was more important. Germany produced capital goods, for which demand was strong, but France continued to produce consumer goods that face the strong price competition, and had low market presence in emerging economies, notably in Asia and in Central Europe.

¶7. Trade Minister Christine Lagarde affirmed "the trade deficit was not worrying," stressing that France is not the

only industrialized country with a trade deficit, and a trade deficit did not impede an economy to grow, citing the U.K and the U.S. She emphasized that French exports did well by historical standards, but acknowledged that France has not enough medium-sized companies involved in foreign trade. In response, the government has launched a program named Cap Export, which regroups measures in favor of export credits, subsidized insurance premiums, tax exemptions, and tax credits.

Comment

¶8. The main policy question to ask is whether the slowdown in growth is due to transitory reasons (e.g., high oil prices, trouble in the suburbs), as claimed by the GOF. Another possibility is that anemic growth is due to policy reasons (e.g., a social system for an aging demographic that increases labor costs; high tax rates and other policies that distort, if not stifle, productive investments that would lead to a better export mix). If the latter is true, and we think so, GDP growth for 2006 is most likely not going to attain the GOF target of 2%, and France's sizable but mature economy will continue to gradually slow down.